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## THE CREAM OF WHEAT CASE

THE fact that the control of the resale price by the manufacturer necessarily involves price fixing is probably the explanation of the decision of the Supreme Court that such control is an undue restraint of trade.<sup>1</sup> The arbitrary fixing of prices has been associated so frequently with restraints of trade and monopolies that the courts naturally look askance at the practice.

The fact that price-fixing is frequently held illegal, however, does not necessarily mean that it is illegal *per se*; nor has it ever been so decided. There may be legitimate as well as illegitimate price fixing, and the question is open to determination on the merits of each case. The decision in the Dr. Miles Medical Company case conflicts with numerous and respectable authorities<sup>2</sup> and has been criticised vigorously on the ground that it represents a case of legitimate price-fixing erroneously classed as illegal.

In considering a doubtful question it is frequently helpful to approach it from several entirely different angles. A case has recently arisen in which the right of a manufacturer to control the resale price of his goods is presented from an entirely new point of view and one which throws much light on the question of whether such control is in fact an undue restraint of trade. This is the case of the Great Atlantic and Pacific Tea Company *v.* The Cream of Wheat Company,<sup>3</sup> now awaiting trial in the federal court for the southern district of New York.

<sup>1</sup> Dr. Miles Medical Co. *v.* John D. Park and Sons Co., 220 U. S. 373.

<sup>2</sup> The following are the leading authorities *contra*: Elliman and Sons Co. *v.* Carington and Son, 2 Chancery Div. 275; National Phonograph Co. *v.* Edison Bell Consolidated Phonograph Co., 1908, 1 Chancery Div. 335; Walsh *v.* Dwight, 58 N. Y. S. 91; Grant *v.* Hall and Lyon Co., 179 Mass. 588; Commonwealth *v.* Grinstead, 111 Ky. 203; Grogan *v.* Chaffee (California), 105 Pac. 745; Ghirardelli *v.* Hunsicker, 164 Cal. 355; Fisher Flouring Mills Co. *v.* Swanson, 76 Wash. 649.

<sup>3</sup> 227 Fed. 46 (C. C. A.), and 224 Fed. 566. The case has been heard on the motion for a temporary injunction in both the district court and circuit court of appeals. The motion in both instances being denied, the case has gone back to the district court for trial.

The question in this case is whether a policy of refusing to sell to price cutters or of inducing wholesalers so to refuse, by threats of cutting off the wholesalers' supply, is a restraint of trade or an attempt to monopolize within the second section of the Clayton Act. The case is of particular interest because of the aspect in which it presents the question of price maintenance, because of the novelty of the question which it raises in regard to whether a refusal to do business may be a violation of the anti-trust laws, and especially because of the important practical bearing which the questions at issue have upon common business practices. Most manufacturers of trade-marked articles refuse to deal with price cutters and in many instances attempt to prevent their jobbers from so doing, by threats of cutting off supplies. If these practices are held illegal the effect upon marketing practices will be far-reaching.

The facts in the case in brief are as follows. The Cream of Wheat Company, the "manufacturer"<sup>1</sup> of the well-known breakfast food, markets its goods in accordance with a sales plan announced in January, 1913, in which it held itself out as refusing to sell to "consumers, retailers, or chain or department stores," and announced that it would refuse to sell to any wholesaler who failed to comply with any request made by the company for its own benefit or for that of the trade at large or of consumers. Sale was to imply no agreement to maintain any resale price, but the company requested that retail stores maintain the price recommended by it. The prices fixed by the Cream of Wheat Company to jobbers were \$4.10 per case of 36 packages when bought in less than carload lots and \$3.95 per case when bought in carload lots. The resale price recommended by the company for the jobber to the retailer was \$4.50 per case, for the retailer to the consumer, 14 cents per package.

The Great Atlantic and Pacific Tea Company is the proprietor of a chain of over a thousand retail grocery stores. Because of the fact that the Tea Company was a purchaser of Cream of Wheat in large quantities, the Cream of Wheat Company con-

<sup>1</sup>The "manufacturing" consists of selecting, cleansing, packing and distributing purified middlings, a by-product of flour manufacture.

sented to treat the Tea Company as a wholesaler, and, in spite of its announced intention to sell to no one but wholesalers, sold to the Tea Company in large quantities and at wholesale rates, on the understanding that the Tea Company observe the minimum resale price of 14 cents per package.

The Tea Company observed the resale price until January, 1915, when it reduced the price in certain of its stores known as "Economy Stores" to 12 cents per package. The Cream of Wheat Company thereupon refused to sell to the Tea Company and circularized the jobbing trade requesting them to see that the Tea Company obtained no Cream of Wheat at any price. The Cream of Wheat Company has been unable entirely to prevent the Tea Company from procuring Cream of Wheat through jobbers, but it has been impossible for the Tea Company to procure Cream of Wheat from jobbers at the carload rate of \$3.95 a case and hence impossible to sell it at 12 cents a package without a loss. The Tea Company, therefore, seeks an injunction under section sixteen of the Clayton Act on the ground that the discrimination of the Cream of Wheat Company against the Tea Company and its attempt to induce jobbers to discriminate constitute a restraint of trade and an attempt to monopolize within the Sherman Act and an unlawful discrimination within the second section of the Clayton Act.

## I

The first question raised by the case is whether the refusal of the defendant to deal with the plaintiff creates a cause of action at all. It is a well established principle of common law that a person may refuse business relations with another for any reason he chooses or for no reason.<sup>1</sup> Has either the Clayton Act or the Sherman Act changed the law in this respect?

The circuit court of appeals disposes of the case shortly by holding that the old law is unchanged. The court says:

<sup>1</sup>Cooley states the common-law right to refuse business relations as follows: "It is a part of a man's civil rights that he is at liberty to refuse business relations with any person whomsoever, whether the refusal rests upon reason, or is the result of whim, caprice, prejudice or malice." Cooley on Torts, p. 278.

Before the Sherman Act, it was the law that a trader might reject the offer of a proposing buyer for any reason that appealed to him ; it might be because he did not like the other's business methods, or had some personal difference with him, political, racial or social. That was purely his own affair, with which nobody else had any concern. Neither the Sherman Act, nor any decision of the Supreme Court construing the same, nor the Clayton Act, changed the law in this particular. We have not yet reached the stage where the selection of a trader's customers is made for him by the government.

The correctness of the decision of the court in so far as the Clayton Act is concerned may be conceded. The Clayton Act, unlike the Sherman Act, prohibits, not general methods or general results, but specific practices only. The act contains no specific prohibition against refusing business relations. The second section on which the Tea Company relies is directed against discrimination "in price." This is radically different from a discrimination in refusing to sell, since a discrimination in price presupposes at least an agreement to sell at some price, not a refusal to sell at any price.

The decision of the circuit court of appeals in regard to the applicability of the Sherman Act, however, is founded on a view of the issue involved with which it is impossible to agree. The court apparently regards the case as presenting the simple issue of the right of a seller in the normal conduct of his business to select his own customers. Considering this as the issue, the court decides that the Sherman Act has no application and that the motives for the rejection of the Tea Company are immaterial.

This view of the case, however, misconceives the issue involved. The issue is not the mere right of the defendant in the normal course of its business to select its own customers, but its right, by a policy of withholding supplies from distributors who fail to maintain its prices, to enforce a system of price maintenance contrary, it is said, to the Sherman Act. The question at issue is not whether the simple selection of one's own customers is legal, but whether one may use such a right of selection in order to accomplish an illegal purpose. The normal and legitimate use of a right is one thing ; the abuse

of the right in aid of an illegal object is another thing. That one may do the first does not justify the conclusion that one may do the second.<sup>1</sup> The defendant's proposed plan of marketing may or may not be illegal, but the plaintiff cannot be thrown out on the ground that defendant had a right to refuse to sell, until the legality of the defendant's plan has been affirmed.

It will be objected that since the defendant has a right to do business with whom it pleases and is under no obligation to sell, there is no duty on the basis of which it can be compelled to sell. The question, however, is not, as the court seems to think, one of compelling the defendant to sell to anyone. It is one of enjoining it from predicated its willingness to sell upon the conditions which, it is contended, the law has declared illegal, and of penalizing it for making discriminations on the basis of the observance or non-observance of such conditions. Whether it is a sound rule that a sale on conditions, freely entered into and accepted by the parties as a bargain, may ever be a restraint of trade is another question. Certainly if there is a rule that sales on conditions are at times illegal, as the *Dr. Miles Medical Company* case and the *Keystone Watch Case Company* case<sup>2</sup> indicate, it is the duty of the court to look beneath the surface of things and to prevent the evasion of the rule by the subterfuge of predicated willingness to sell

<sup>1</sup> The distinction between the normal exercise of the right to refuse business relations and the right to use that right to attain an illegal end is recognized in the dissenting opinion of Justices Day and Holmes in the case of *Coppage v. Kansas*, 236 U. S. 1. Coppage had been convicted under a statute making it a misdemeanor to require, as a condition of continuing in or obtaining employment, a promise not to become or remain a member of a labor organization. In contending for the constitutionality of the statute Justice Day said (p. 40), "But it is said that in this case all that was done in effect was to discharge an employee for a cause deemed sufficient to the employer, a right inherent in the personal liberty of the employer protected by the Constitution. This argument loses sight of the real purpose and effect of this and kindred statutes. *The penalty imposed is not for the discharge but for the attempt to coerce an unwilling employee to forego the exercise of the legal right involved as a condition of employment.* It is the requirement of such agreements which the State declares to be against public policy." (Italics are author's.) So in the *Cream of Wheat* case it is the attempted coercion of dealers to forego the right which acquisition of title normally gives, that is, to fix the conditions of subsequent alienation to suit one's self, against which relief is asked.

<sup>2</sup> 218 Fed. 502.

upon the observance of the illegal conditions. The embarrassment of penalizing a man for a refusal to sell and the possible difficulty of proving discrimination call into question, not the policy of preventing evasion of the rule that a seller cannot prescribe the conditions upon which he will sell, if the rule exist, but rather the soundness of the rule itself.

It will be objected that the refusal in itself being legal, the purpose with which it is made cannot render it illegal. The fact that an act in itself is legal, however, does not confer the right to do it for illegal ends. This is particularly true in the application of the Sherman law. The Sherman Act in contrast to the Clayton Act is not confined to the prohibition of specific practices, but is aimed at general results. The act enumerates certain results and then declares them illegal irrespective of the methods by which they are accomplished. The Supreme Court has interpreted the sweeping language of the act to prohibit every practice or device, regardless of its specific character, by which the prohibited results are accomplished or threatened. In the Standard Oil case, speaking of the first section of the act, the court said :

In view of the many forms of contracts and combinations which were being evolved from existing economic conditions, it was deemed essential by an all embracing enumeration to make sure that *no form of contract or combination by which an undue restraint of interstate or foreign commerce was brought about would save such restraint from condemnation*. The statute under this view evidenced the intent not to restrain the right to make and enforce contracts, whether resulting from combination or otherwise, which did not unduly restrain interstate or foreign commerce, but *to protect that commerce from being restrained by methods, whether old or new, which would constitute an interference that is an undue restraint*.<sup>1</sup>

Speaking of the second section of the act the court said : "Undoubtedly, the words 'to monopolize' and 'monopolize' as used in the section reach *every act* bringing about the prohibited results."<sup>2</sup> These views were reiterated in the Tobacco

<sup>1</sup> Standard Oil Co. v. United States, 221 U. S. 1, p. 39. Italics are author's.

<sup>2</sup> Italics are author's.

case where the court, referring to the Standard Oil decision, said:

. . . it was pointed out that the generic designations of the first and second sections of the law, when taken together, embraced *every conceivable act* which could possibly come within the spirit or purpose of the prohibitions of the law, without regard to the garb in which such acts were clothed. That is to say, it was held in view of the general language of the statute and the public policy which it manifested there *was no possibility of frustrating that policy by resorting to any disguise or subterfuge of forms, since resort to reason rendered it impossible to escape by any indirection the prohibition of the statute.*<sup>1</sup>

Under this view many practices, not only perfectly legal in themselves, but constituting part of a man's civil rights, have been held illegal when they caused or threatened results prohibited by the statute.<sup>2</sup> Thus it is part of a man's civil rights

<sup>1</sup>United States *v.* American Tobacco Co., 221 U. S. 106, at p. 180. Italics are author's.

<sup>2</sup>That the intent (as distinguished from the mere motive) may render otherwise innocent acts or practices illegal under the Sherman law is well established. Leading cases on this point are: *Swift & Co. v. United States*, 196 U. S. 375, at p. 396; *United States v. Terminal Railroad Association St. Louis*, 224 U. S. 383, at pp. 394-395. *United States v. Union Pacific R. R.*, 226 U. S. 61. In the *Swift* case Mr. Justice Holmes, speaking for the court, said (p. 396): "It is suggested that the several acts charged are lawful and that intent can make no difference. But they are bound together as the parts of a single plan. The plan may make the parts unlawful."

In the *St. Louis Terminal R. R.* case Mr. Justice Lurton, who wrote the opinion, said: "It is not contended that the unification of the terminal facilities of a great city where many railroad systems center is, under all circumstances and conditions, a combination in restraint of trade or commerce. Whether it is a facility in aid of interstate commerce or an unreasonable restraint forbidden by this court in the cases of *The Standard Oil Company v. The United States*, 221 U. S. 1, and the *United States v. The American Tobacco Company*, 221 U. S. 106, will depend upon the intent to be inferred from the extent of the control thereby secured over instrumentalities which such commerce is under compulsion to use, the method by which such control has been brought about and the manner in which that control has been exerted."

In the *United States v. Union Pacific R. R. Co.*, Mr. Justice Day, speaking for the court, said (p. 193): "In determining the validity of this combination we have a right to look also to the intent and purpose of those who conducted the transactions from which it arose and to the object had in view." The same point is made in

to dispose of his property in such assortments or selections and usually on such conditions as he sees fit. In the decree against the Tobacco Company, however, each of the fourteen companies created from the original was enjoined from making the sale to any jobber of any brand of any tobacco product manufactured by it conditional upon the purchase from the vendor of some other brand or product also manufactured or sold by the vendor "where the effect would be unduly to restrain or or monopolize commerce."<sup>1</sup> To dispose of one's products at whatever price one sees fit is also part of one's civil rights, yet the defendants in the Powder Trust case were enjoined from offering customers of rival manufacturers better prices or terms of sale than they offered their established trade, where the purpose was unfairly to cripple or destroy the business of the rivals.<sup>2</sup> Finally in the case of *United States v. Keystone Watch Case Company*<sup>3</sup> the right to select one's own customers was itself involved. In that case the Keystone Watch Case Company issued a circular announcing its intention to refuse to sell to jobbers who handled its competitors' goods. The court held that the effect of the threat in depriving competitors of their channels of distribution was an unlawful restraint of trade and that, in spite of the fact that the Keystone Company had a right to select its own customers, the discrimination for the above reason might be enjoined. This case is particularly important because it is a concrete illustration of the manner in which the right to select one's own customers may be used to restrain trade. By the simple method of refusing business relations with distributors who handle the goods of competitors, a well known and long established manufacturer may impose serious obstacles to a new competitor gaining access to the market.

*Nash v. United States*, in which the court, referring to the *Standard Oil and American Tobacco Company* cases, said: "Those cases may be taken to have established that only such contracts and combinations are within the act as *by reason of intent* or the inherent nature of the contemplated acts, prejudice the public interests by unduly restricting competition or unduly obstructing the course of trade." (Italics are author's.)

<sup>1</sup> Reprinted in *Stevens, Industrial Combinations and Trusts*, p. 459.

<sup>2</sup> *Ibid.*, p. 469.

<sup>3</sup> 218 Fed. 502.

It will be objected that the above interpretation of the statute brings it in conflict with the Fifth Amendment forbidding the deprivation of property without due process of law. Since the common law holds contracts and combinations in undue restraint of trade and monopolies contrary to public policy, it may be questioned whether the due-process clause protects the exercise of individual freedom when the intent or necessary effect of such exercise is to impose undue restraints of trade. The power of Congress over commerce necessarily gives Congress the authority to prohibit the exercise of individual liberty when the effect is directly and substantially, and not merely incidentally and collaterally, to interfere with interstate commerce.<sup>1</sup> To hold otherwise would be to permit individuals to restrain trade and thus to subordinate the power of Congress over commerce to that of private individuals. The cases of *Adair v. United States*<sup>2</sup> and of *Coppage v. Kansas*,<sup>3</sup> which may be cited as authority for the proposition that the right to refuse business relations may not be restricted, are not in point since they decide merely that the protection of union members from discrimination is not sufficiently an object of the public welfare to validate the restriction on the right to select one's own employees. It is well settled,

<sup>1</sup> For a discussion of the power of Congress to restrict private rights under the commerce clause see *United States v. Joint Traffic Association*, 171 U. S. 505, at p. 572, and especially *Addystone Pipe and Steel Company v. United States*, 175 U. S. 221, at pp. 228-230. Although these cases had reference primarily to the right of freedom of contract, the language is equally applicable to the right to select one's customers since both rights are part and parcel of the same general right of liberty and the Fifth Amendment applies equally to them both. In the *Addystone Pipe and Steel Co.* case the court (at p. 230) said: " . . . we think the provision regarding the liberty of the citizen is, to some extent, limited by the commerce clause of the Constitution, and that the right to enact a law prohibiting the citizen from entering into those private contracts, which directly and substantially and not merely indirectly, remotely, incidentally and collaterally regulate in a greater or lesser degree commerce among the States.

"We cannot so enlarge the scope of the language of the Constitution regarding the liberty of the citizen as to hold that it includes or that it was intended to include a right to make a contract which in fact restrained and regulated interstate commerce, notwithstanding Congress, proceeding under the constitutional provision giving to it the power to regulate that commerce, had prohibited such contracts."

<sup>2</sup> 208 U. S. 161.

<sup>3</sup> 236 U. S. 1.

however, that the protection of trade from restraints and monopolistic practices is within the authority to regulate commerce.<sup>1</sup>

## II

The case raises another question which was not discussed by the circuit court of appeals, and that is whether a *combination*, or attempted combination, to maintain the resale price is not created, when, as a result of a manufacturer's refusal to sell to jobbers who sell to price cutters or who themselves refuse to maintain a standard wholesale price, the jobbers refuse to sell to price cutters and refuse to cut the standard wholesale price. The Supreme Court has decided on several occasions that a concerted refusal of business relations may be an undue restraint of trade, even where an individual refusal would be permissible and even though the refusal be a primary boycott such as in itself is not ordinarily a tort.<sup>2</sup> Since it is a frequent if not an almost universal practice among manufacturers who wish their

<sup>1</sup> The objection may be made that the prohibition of the Sherman Act against restraints of trade applies only to contracts and combinations in restraint of trade and that an individual refusal involves neither a contract nor a combination. If the purpose of the refusal be illegal, however, the refusal is but an indirect way of forcing on the other party a restriction that could not be imposed by contract. It is well settled, however, that the statute may not be evaded by indirection. The principle is well stated by Judge McPherson in *United States v. Keystone Watch Case Company*, 218 Fed. 502, whose opinion is quoted with approval by Judge Hazen in *United States v. Eastman Kodak Company*, 226 Fed. 62, at p. 66: "If it [the restraint of trade] be both direct and undue, no disguise will save it; the courts will search for the substance and actual effect of the transaction, and, if trade be unlawfully restrained thereby, will grant the needful relief."

It is also settled (*Standard Oil Company v. United States*, 221 U. S. 1, at p. 61) that the term "monopolize" in the second section of the act is synonymous with "restraint of trade" in so far as the effect of restraint of trade upon the public is concerned and that the section prohibits all acts by individuals which, on account of their effect on the public, would be illegal under the first section if done by combinations. It is unnecessary, therefore, that there be a combination, providing the actual effect is unduly to restrain trade.

<sup>2</sup> The leading cases on the point are *Grenada v. Mississippi*, 217 U. S. 440, and *Eastern Retail Lumber Dealers' Association v. United States*, 234 U. S. 600, both of which involved concerted action on the part of retail lumber dealers to refuse to *purchase* from wholesalers or manufacturers selling directly to consumers in competition with the members of the combine. It will be noticed that the boycott was "primary" in that it was aimed directly against those whom it was intended to injure. The fact that the refusal was to *buy* instead of sell is of course immaterial.

price maintained to refuse to sell to jobbers who sell to price cutters and often also to jobbers who refuse themselves to maintain a standard wholesale price, it is particularly important to know whether such a practice creates a combination, which may be illegal irrespective of the legality of an individual refusal to sell.

It is well settled that an express agreement is not necessary to create a combination within the meaning of the Sherman law. A tacit understanding is sufficient. The essential thing is that there must be concerted action toward a uniform object. By concerted action is meant not coincident independent action, but conscious coöperative action in aid of a joint undertaking.

Under the above rule it is difficult to see how a conclusion of concerted action within the meaning of the law can be avoided. The individual refusals of the distributors and manufacturer to sell at cut prices or to price cutters are not unrelated, independent acts, but are part of a general plan to maintain the resale prices, both wholesale and retail, to which each distributor is compelled by the manufacturer's threats to become a party. Although there is no express contract or agreement to maintain wholesale prices and to prevent price-cutting retailers from procuring goods, the threat of the manufacturer to cut off supplies brings about a concert of action as surely as would an express agreement. In the *Dr. Miles Medical Company* case a contract embodying the above conditions was held "in effect" to create a "combination for the prohibited purposes" (referring to the purposes prohibited by the Sherman Act). In view of the rule that the act may not be avoided by "any disguise or subterfuge of form" it would seem impossible for the concerted action, produced by the manufacturer's threat, to escape the prohibitions of the act, providing its purposes come within the act.

### III

The issue both in the case of the individual discrimination by the manufacturer and of the concerted discrimination by distributors induced by the manufacturer appears to narrow down to the question: Is the purpose in aid of which the discrimination is practiced illegal within the Sherman Act? It may seem

harsh to penalize a manufacturer for discriminating or for inducing others to discriminate against distributors whose proven policy in disposing of the manufacturer's products is one considered injurious to the manufacturer's business. Such discrimination would seem only a legitimate protection to the manufacturer's own business rather than a restraint of trade. This, however, is the inevitable result if an attempt to maintain the resale price of his own goods by a single manufacturer constitutes an undue restraint of trade. The question of whether a manufacturer has the right to discriminate himself or to form a combination of his distributors to discriminate against price cutters, forms an excellent test of the soundness of the rule laid down in the *Dr. Miles Medical Company* case, that the maintenance of the resale price by a single manufacturer on his own products is illegal.

The question of the legality of the maintenance of the resale price takes us back to the decision of the district court where this question was discussed at length. The court decided that the maintenance of the resale price by a single manufacturer is not an undue restraint of trade within the Sherman Act, for the reason that the only competition which is restrained is competition of the article with itself and that this competition is not of the sort which the law protects. The court said :

The only competition prevented or sought to be prevented by defendant's acts is that of *Cream of Wheat* against itself ; the only trade restrained is the commercial warfare of a large buyer against small ones, or that of a merchant who for advertising purposes may sell an article for a loss, in order to get customers at his shop, and then persuade them to buy other things at a compensating profit. That competition as encouraged by statutes and decisions, does not include such practices, has been sufficiently shown (with ample citations) in *Fisher Flouring Mills Company v. Swanson*, 76 Wash. 649.

The district court here presents a distinction which is obviously contrary to the decision of the Supreme Court in the *Dr. Miles Medical Company* case. The Supreme Court simply held that the restriction of competition in the resale of the article through the fixing of a uniform resale price is an undue

restriction on competition, without qualification as to the character of the competition suppressed. The court said :

. . . where the commodities have passed into the channels of trade and are owned by dealers, the validity of agreements to prevent competition and to maintain prices is not to be determined by the circumstance whether they were produced by several manufacturers or one, or whether they were previously owned by one or by many. The complainant having sold its product at prices satisfactory to itself, the public is entitled to whatever advantage may be derived from competition in the subsequent traffic.<sup>1</sup>

The soundness or unsoundness of the position of the Supreme Court depends upon the import attached to the words "restraint of trade."

The interpretation of this phrase has been the most troublesome thing in the interpretation of the Sherman Act. The difficulty has been to formulate a rule by which, on the one hand, the minor restraints of trade which are necessary if freedom of trade in the larger sense is to exist, would be permitted, and by which, on the other hand, the fundamental restraints which involve a destruction of the freedom of trade in the larger sense would be prohibited—a rule which would permit some restraints and forbid others and yet which would be consistent with the sweeping prohibitions of the statute against "all" restraints of trade. Not every restraint of trade at common law was unlawful. To apply the blanket prohibitions of the statute to every restraint known at common law regardless of its previous legality, would be to "fulfill the promise of the statute to the ear but to break it to the hope." The anomaly of an act literally at variance with its purpose was destroyed by the technically indefensible but economically sound opinion in the Standard Oil Case, which said that the general and all-inclusive terminology of the statute had reference to the *means* of restraint or monopolization and was intended to apply the prohibitions to all devices and practices in aid of the prohibited results regardless of their form, but that the *results* prohibited were to be

<sup>1</sup> 220 U. S. 373, at p. 409.

understood in the light of the common law—the so-called rule of reason.<sup>1</sup>

The decisions in regard to the rule of reason are unsatisfactory because they either state mere conclusions in regard to the legality of a given state of facts without indicating the criteria by which the judgment was reached, or because, when principles are stated, the extent of their application is not given. The following summary of the rules, however, errs, if at all, on the side of overstating rather than understating the application of the rule against restraints:

1. Restraints of trade involving or threatening a substantial control of the market are illegal irrespective of their specific character.

2. Restraints not involving or threatening a substantial control of the market are illegal when oppressive, predatory or unfair in their nature.

3. Restraints going no further than necessary to protect the legitimate interests of the party imposing them and neither involving nor threatening a substantial control of the market, or unfair, predatory or oppressive in their nature, are legal.

How can the control of the price of no more than a single brand of a commodity be construed as a control of the market of the commodity? Control of the market implies power to fix the general price level at which the commodity is sold, power to exclude or coerce competitors, to prevent distributors from handling competitors' goods or to compel them to discriminate against competitors' goods. The right to control the resale price of the products of his own manufacture gives the manufacturer power to do none of these things, nor is it desired in order to accomplish any of them. The control of the resale price instead of being designed to control the market is simply an internal measure in the regulation of the marketing of the manu-

<sup>1</sup> The court referring to the act said: "Thus not specifying but indubitably contemplating and requiring a standard, it follows that it was intended that the standard of reason, which had been applied at the common law and in this country in dealing with the subjects of the character embraced by the statute, was intended to be the measure used for the purpose of determining whether in a given case a particular act had or had not brought about the wrong against which the statute provided."

facturer's particular brand. It does not extend the manufacturer's power beyond his own products. It does not enable him to affect the price at which his competitors shall sell their goods, nor to exclude them from the market or cause their goods to be discriminated against. Competitive conditions still prevail and the free interplay of supply and demand is not interfered with. Instead of controlling the market the manufacturer is himself controlled by the market and is governed by the market in fixing his resale price. The sole power which the manufacturer has and the sole reason why he desires the right to control his resale price is, not to raise the price above that established by the unrestricted operation of supply and demand, but to prevent the price on his product for purely advertising purposes from being cut below the competitive market price.

#### IV

Does the control of the resale price by a single manufacturer of his own products constitute an oppressive, predatory or unfair restriction upon the freedom of others to conduct their business as they see fit?

It is to be noted that this question concerns solely the two parties who freely enter into the bargain. It does not involve third parties as did the *Keystone Watch Case Company* case, where the restriction related to the right to handle competitors' goods. It does not involve the public, since no control of the market is created. It is a pure case of what has been termed a "subjective restraint of trade," that is, a restraint entered into voluntarily between the parties and concerning them alone. The rule in regard to such restraints is that the restriction will be upheld if it goes no further than to protect the legitimate interests of the restraining party.<sup>1</sup>

There is a tendency in the discussion of this question to view the protection as concerning the right of the manufacturer, *after* having sold the goods, to dictate the price at which they shall

<sup>1</sup> Mr. Chief Justice Fuller, in *Fowle v. Park*, 131 U. S. 88, at p. 97, states the rule applicable to subjective restraints as follows: "Public welfare is first considered, and if it be not involved, and the restraint upon one party is not greater than the protection to the other requires, the contract may be sustained."

be resold. Nothing is further from the truth. The question solely is of the right of the manufacturer, before or at the time of the sale, to stipulate the price at which the goods shall be resold. If the distributor does not like the conditions he is free to refuse the goods. The question is, can the distributor, being free to take or reject as he chooses, and having elected to take the goods, complain that he is being oppressed or that his freedom to conduct his business as he sees fit is restrained when he is forced to live up to his bargain?

It is objected that, having parted title with the goods, the manufacturer has no further interest in them, and that the restriction being unsupported by an interest is contrary to public policy and void.

It has been attempted to make out an interest of the manufacturer on the theory that an injury is done the reputation of his goods by having them bandied about at bargain prices. This theory is questionable both because of the uncertain policy of protecting the value founded merely on prestige and because of the uncertainty of the proposition itself that goods of merit suffer a loss of prestige by having their price "cut."<sup>1</sup> There is another ground, however, on which a legitimate interest can be made out. That is the effect of price cutting on the sales of the manufacturer to his distributors and on his distributing system.

There is a double relationship between the manufacturer and his distributors. In the first place there is the simple relationship of buyer and seller. The distributors are the manufacturer's customers on whom he depends for his profits and whose volume of purchases determines his profits. It will not be denied that the manufacturer has a vital and legitimate interest in inducing these purchasers to purchase as frequently and in as large quantities as possible, and that in making reasonable regulations to prevent their willingness to purchase from being interfered with, he does no more than protect his legitimate

<sup>1</sup> It is said that the public is learning to understand the bargain "game" so well, that an article is not "cheapened" by being cut. For a discussion of this phase of the subject, see Professor F. W. Taussig's address in *Proceedings of American Economic Association*, 1915.

interest. If he believes that if he sells to A he will lose some or all of B's patronage, no one will deny his right to refuse to sell to A altogether. It is a matter solely in the regulation of his own business. So also if, instead of refusing to sell to A absolutely, he sells with a condition subsequent attached for the purpose of protecting his trade with B, that would not appear unreasonable, provided the condition in fact went no further than necessary to protect his trade with B. Finally, if, instead of imposing the condition in a discriminating fashion upon a few customers, he imposes it uniformly and without discrimination upon all alike, it would appear to be still more a reasonable regulation of his business.

The distributors of the manufacturer's goods, however, are more than mere customers. In practical effect they are as essential a part of his marketing organization as are his own salesmen, and on their efficiency and interest in pushing his goods depends to a great extent the volume of his sales. Recognizing this fact, manufacturers spend large sums in preparing so-called "dealers' helps" such as electrotypes, window trims, lantern slides etc., to aid dealers in marketing their goods. Some manufacturers go so far as to maintain dealers' service departments to help the dealers in their selling problems, provide courses in salesmanship for dealers' clerks, and employ travelling "efficiency" men to help dealers with their problems on the spot.

That the manufacturer has an interest in this distributing organization, and that he may be injured through an injury to it, have been clearly recognized by the courts in numerous cases holding a secondary boycott illegal. One of the most recent and best known cases is that of *Loewe v. Lawlor*,<sup>1</sup> where it was held that a boycott directed against dealers handling the manufacturer's goods constituted an actionable injury to the manufacturer in spite of the fact that the goods offered for sale by the dealers had wholly ceased to be the property of the manufacturer and were the property of the dealers. In the case of *the United States v. The Keystone Watch Case Company*<sup>2</sup> a

<sup>1</sup> 208 U. S. 274.

<sup>2</sup> 218 Fed. 502.

threat to refuse to sell to jobbers handling competitors' goods was held to constitute an undue restraint of trade, not because it interfered with the trade of the jobbers, but because it interfered with the trade of the competitors by closing to them their channels of distribution.

The reason why cutting the resale price injures the manufacturers' trade with his distributors and disorganizes his distributing system is that it makes it unprofitable for distributors to handle his goods. The fact that price cutting destroys the profit in the particular brand in most cases may not induce the dealer to drop it altogether,<sup>1</sup> for he will carry a supply for those who ask for it. The sale of the brand, however, depends to a great extent upon the willingness of dealers to push it by displaying it attractively on the counters, and in the windows, and recommending it to customers. This the dealer will not do unless assured of a reasonable profit. A well-known watch manufacturer found that his sales to distributors in a city where his product was subject to severe price cutting fell off one-half. The advertising and sales manager of a well-known manufacturer of toilet articles estimates that one-third of his sales are directly due to the influence of retailers. The influence of the retailer in determining the consumer's choice is shown by an investigation of the *Chicago Tribune* in regard to how women were induced to use their favorite food products. This inquiry showed that out of 30,936 instances the manufacturer's advertising was responsible for the choice in 11,322 cases or 36 per cent, the advice of the dealer in 16,527 or 55 per cent, the advice of friends in 1889 or 6 per cent, and in 1198 cases no definite reason was given.<sup>2</sup> To deny the manufacturer the right to place restrictions upon the resale price of his goods is to deprive him of the opportunity to assure himself of the benefit of the dealer's influence.

The situation is perhaps made clearer by an examination of

<sup>1</sup> Except in the case of exceptional lines the claims of advocates of price maintenance on this point do not appear to be substantiated.

<sup>2</sup> The 30,936 instances above given do not represent that number of individual persons, but rather the experience of a lesser number of persons each with a number of articles.

the nature of the conflict out of which the price-maintenance controversy arises. The dispute springs from the competition between the manufacturer and retailer for the good-will of the consumer. The competition for this good-will, although not frequently referred to in economic writings, is most real and keen. It is comparable to the competition between capital and labor for shares in the income from their joint services. The manufacturer strives to attach the consumer's good-will to his brand of goods and the retailer strives to attach it to his store, because the possession of the consumer's good-will gives him an advantage in the bargaining over the division of the profits on the goods.

The mere use of the cut price on the manufacturer's products by retailers as an advertising device in this struggle for the consumer's good-will would probably encounter little opposition from manufacturers were it not that there are many small dealers who have not the resources to advertise extensively or to stand the losses on cut prices, who are willing to push the manufacturer's products among their trade if assured of a reasonable profit. It is because price cutting deprives the manufacturer of the support of these small dealers in establishing his product in favor with the public that he objects to it.

Viewed in this light the question of price maintenance is essentially a question of the right of one of two competitors to sell his goods subject to such conditions as will assure him of the support of those who are willing to assist him in his competition, and which will prevent his rivals from utilizing the products he manufactures to his own disadvantage. These surely are reasonable considerations. A man is certainly entitled to impose suitable restrictions upon the sale of his goods to protect those who are willing to assist him in his competition.<sup>1</sup> The legitimacy of the restrictions is still more obvious

<sup>1</sup> Distinguish between restrictions designed to reward or protect those who are willing to assist the manufacturer in his competition, from those which are designed to impose pressure on others to force them to give their support to him and to withhold it from third parties, such as were held illegal in the *Keystone Watch Case* Company case. The question of price maintenance involves no question of pressure or coercion nor any question of the rights of third parties.

when the only persons who are injured by the restrictions are those who intend to use the goods to build up a rival good-will with the public. Nor is there any reason apparent why a man may not take suitable measures to prevent the goods he sells either from falling into the hands of his rivals or from being utilized by them to injure him. A man is not bound to furnish ammunition to his rivals. To deny the manufacturer the power to sell his goods subject to stipulations concerning their immediate and subsequent alienation is in effect to compel him to sell to those whose deliberate purpose in purchasing his goods is to use them as a weapon against him in the struggle for the public's favor, for, although price cutters may not be able to procure goods from him directly, they will obtain them indirectly.

## V

The foregoing analysis discloses the essential nature of price maintenance. It shows that price maintenance is not an *aggressive* device, but on the contrary it is a *protective* device. Its purpose is not to assert control over the market or to oppress any individual and it carries with it no such powers. It simply permits an individual manufacturer to stipulate as a condition to his willingness to deal with the distributor, that a given resale price be maintained and that the goods shall not be sold except subject to an agreement that a given resale price be maintained. If the prospective vendee does not find the conditions agreeable he is not compelled to accept them, for the market is free and he may purchase where he chooses. Once having accepted the condition, however, and having taken the goods, he is held to be bound by his agreement as he would be with respect to any other conditions of the sale. Baldly stated, it is simply a condition in a contract of sale by which the vendor seeks to prevent the vendee from using the vendor's success in creating a good-will, as the basis for building up a competing good-will of his own.

It may be that the Supreme Court has committed itself too positively and unequivocally on this question for it to recede. If that is the case, the situation in the Cream of Wheat case is valuable as an indication of the need of legislative relief. It

happens that the court of appeals in the present case has found a means of avoiding the consequence of logical adherence to former decisions. The results to which the logical adherence to precedent would lead, however, are criteria of the soundness of the precedents themselves. A rule which if applied consistently would render a man guilty of restraint of trade for refusing to sell to one who designed to use the goods in ways injurious to the seller's business, must be unsound in its very essence and hence in all its applications.<sup>1</sup>

<sup>1</sup> No attempt has been made to deal with specific objections to price maintenance because in view of their multifarious character and in many cases of the misunderstanding of the subject on which they are based, it was felt a simple analysis of the subject would be clearer and in most cases an answer in itself. Professor Taussig's main objection, however, should be noticed:

"It stands in the way of the experimenter. As regards the spread between producer and consumer, it looks to the maintenance of the *status quo*." (*Proceedings American Economic Association*, 1915, p. 181.)

It is true that the national advertisers, who are the principal supporters of price maintenance, view the mail-order houses, chain stores and department stores as their chief rivals, and that there is fierce competition between these groups for the public's good-will. To the extent that price maintenance prevents these new distributors from preying off the manufacturer's good-will, it stands in the way of experimenters. It stands no further in the way of experimenters, however, than to give them stiff competition and to prevent them from parasitically using the advertising of others as the basis of their own advertising. The freedom of the market is not impaired, nor is any unfair advantage given a man in allowing him to sell his goods on the conditions he sees fit.

The assertion that price maintenance looks to the maintenance of the *status quo* as regards the spread between producer and consumer is not borne out by the facts. The advertisers have no particular interest in the double middleman as such, and price maintenance does not bind them up to it. Their interest, like that of any other manufacturer, is solely in placing their goods on the market as cheaply and expeditiously as possible. If the majority of national advertisers adhere to the double-middleman system it is because of the impossibility of economically distributing small products to thousands of retailers directly.

If the reference be to the jobber's and retailer's margin of profit, the tendency of manufacturers' advertising has been to reduce rather than maintain or increase it, for the simple reason that it has strengthened the manufacturer's bargaining power relatively to that of retailer and jobber. As the tendency of price maintenance is further to strengthen this power, its tendency must be deemed to reduce rather than maintain or increase the middleman's share.

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